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Supreme Court of the United States

OCTOBER TERM, 1975

No. 75-1423

KENTUCKY UTILITIES COMPANY, *Petitioner*

v.

FEDERAL POWER COMMISSION

REPLY AND SUPPLEMENTAL BRIEF OF PETITIONER KENTUCKY UTILITIES COMPANY

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Pursuant to Rule 24(4) and (5) of the Court, Kentucky Utilities Company ("KU") submits this brief in reply to those arguments first raised in the briefs in opposition to KU's petition for a writ of certiorari which were filed by the Electric and Water Plant Board of the City of Frankfort, Kentucky, *et al.* ("Cities") and the Federal Power Commission ("FPC" or "Commission") and to call to the Court's attention several relevant decisions emanating from the FPC after KU's petition was filed.

1. The Cities' Contention That the Facts Alleged by KU in Requesting a Hearing Were Undisputed by the Cities Is Fallacious.

The Cities contend that "the facts upon which KU presented its claim were made known to the FPC *and*

were undisputed by the Cities" (Br. 11, emphasis added), and that "the facts alleged by KU were *uncontested* by the Cities" (Br. 4, emphasis added). This is the first time in this long controversy that the Cities have alleged that the facts upon which KU relies and which it requested an opportunity to prove before the Commission were "uncontested" and "undisputed". The Cities previously have always simply characterized KU's factual allegations as to the practical construction of the contracts by the parties and the Kentucky Public Service Commission prior to KU's filing of the contracts with the FPC as "irrelevant" and "immaterial.[1] However, even when they were taking that carefully framed position as to those pre-1963 underlying facts, there was clearly a major dispute between them and KU with respect to what took place *after* 1963 when KU effected its two substantial rate reductions to the Cities in 1965 and 1969.

For example, in their initial motion to reject KU's rate increase filing before the FPC the Cities asserted that "both KU and the Federal Power Commission have in the past treated KU's contracts with the Cities as fixed rate contracts" and that "the FPC has consistently refused to allow unilateral rate changes to be made by KU under these contracts." (R. 303, 310). KU disputed that assertion in its answer to Cities' motion (R. 356-57) and in its application for rehearing of the Commission's order of June 29, 1973 rejecting KU's rate filing (R. 380-81, 384-86).

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[1] "Motion of Eleven Wholesale Customers To Reject Rate Filing, Protest, and Petition to Intervene", FPC Docket No. E-8172, June 14, 1973, p. 11 (R. 310); "Brief for Electric and Water Plant Board of the City of Frankfort, *et al.*," C.A.D.C. No. 73-2085, February 8, 1974, pp. 14, 18.

The Cities' brief before the court of appeals reiterated their view that "the contracts here in issue have thus been consistently treated as fixed-rate contracts" (p. 20), which KU stressed in its briefs was one of the principal points it wished to refute in the hearing it was seeking. To reveal the utter fallacy of the Cities' brazen assertion that the facts surrounding the 1965 and 1969 rate reductions were "undisputed", KU sets out in Appendix A to this brief extracts from its briefs before the court of appeals presenting its version of those events which it was denied an opportunity to prove.

They clearly demonstrate, contrary to the Cities' present representation to the Court, that there was a major factual dispute with respect to the practical and administrative construction of the disputed contracts which the FPC refused to ventilate in a hearing.

2. The Commission's Interpretation of the Disputed Contracts Did Not Involve an Exercise of Its Expertise and Is Therefore Entitled to No Deference on Review.

The FPC's memorandum in opposition asserts (p. 3) that the court of appeals properly deferred to the Commission's interpretation of the disputed contracts because it allegedly involves the exercise of the Commission's regulatory expertise. Although the Commission did not make that argument below, the court of appeals did rely on it (Pet. App. 18a). However, reliance on that doctrine is misplaced because there are no questions of expertise involved here, only the application of "ordinary rules of contract law."[2]

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[2] *Texas Gas Trans. Corp.* v. *Shell Oil Co.*, 363 U.S. 263, 268-70 (1960), followed in *Skelly Oil Co.* v. *FPC*, 532 F.2d 177 (10th Cir. 1976) which collects the authorities rejecting this boilerplate argument of the FPC.

3. The Salutary Consequences of Affording a Hearing on Disputed *Mobile-Sierra* Issues Has Been Vividly Demonstrated by a Recent Initial Decision by an FPC Administrative Law Judge.

KU argued unsuccessfully before the Commission and the court of appeals that it was entitled to a hearing to demonstrate that there was no intent by either KU or the Cities to enter into "fixed rate" agreements, stressing that the Commission's power to suspend the filed rates pending a hearing would fully protect the Cities if the Commission should ultimately conclude that the contracts were in fact fixed rate agreements (Pet. 24-28). A recent decision issued by an FPC administrative law judge in *Philadelphia Electric Company* (Docket Nos. E-7795, E-7989) on June 28, 1976 confirms KU's contention that an evidentiary hearing is essential to put barebone electric rate provisions, such as those in KU's contracts with the Cities, in proper perspective.

The *Philadelphia Electric* decision resulted from a hearing under section 206(a) of the Federal Power Act (16 U.S.C. § 824e(a)) conducted by the FPC after the Court of Appeals for the District of Columbia Circuit in *Borough of Lansdale* v. *FPC*, 494 F.2d 1104 (1974), had held, without the benefit of a hearing record below, that language in Philadelphia Electric's contract with Lansdale precluded unilateral rate increase filings by Philadelphia Electric under section 205 of the Federal Power Act (16 U.S.C. § 824d). In his decision in the section 206 proceeding, Judge Southworth was required to deal with the contract interpretation issue even though it was not before him for decision, inasmuch as it had been raised by Lansdale in another context. After reviewing the extensive evi-

dence surrounding the negotiation of the Lansdale contract, he concluded as follows (Mimeo, p. 26):

> The 1971 contract has been ruled [by the court of appeals] to be a fixed rate contract, and that is the law of the case under the currently effective order of the Commission. The evidence shows, nevertheless, that neither Philadelphia nor Lansdale negotiated for that result. On the contrary, the evidence which Lansdale invited demonstrates that both parties expected the rates to increase, upon a filing by Philadelphia, soon after, if not contemporaneously with, the extension of service to Lansdale.

4. A Recent FPC Decision Demonstrates the Almost Absolute Impossibility of Obtaining Relief under Section 206(a) of the Federal Power Act After a Contract Has Been Held To Contain Fixed Rate Provisions.

In its petition KU stressed that a vitally important reason for requiring the FPC to grant a hearing on disputed contract issues is the virtual impossibility of obtaining relief from the Commission under section 206(a) of the Federal Power Act after a contract has been held to embody fixed rates in light of the Commission's unduly constricted view of the "public interest" criteria which this Court held in *FPC* v. *Sierra Pacific Power Co.*, 350 U.S. 348 (1956), would justify modification of fixed rate contracts (Pet. 35-38). The Commission's myopic view of the *Sierra Pacific* standards is vividly illustrated by its decision in *Metropolitan Edison Company* (Opin. No. 764) issued on June 1, 1976, a copy of which is included as Appendix B to this brief.[3] In that case the Commission refused to

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[3] The Commission issued an "Order Denying Rehearing" on July 30, 1976 which is included as Appendix C.

modify a contract entered into between the Borough of Middletown, Pennsylvania and Met Ed's predecessor-in-interest in 1906 by which Middletown was to receive its entire power supply requirements (whatever they may be) "in perpetuity" for 1 cent per kilowatt hour. That contract is currently yielding Met Ed $500,000 less per year than it would receive under the rates presently being charged Met Ed's other comparable wholesale customers, who pay rates approximately 150 percent higher than Middletown. The Commission's opinion speaks for itself, and fully validates KU's contention as to the hopelessness permeating the electric utility industry in connection with the Commission's application of the *Mobile-Sierra-Memphis* doctrine.

Respectfully submitted,

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APPENDIX

APPENDIX A

"Brief for Petitioners" (January 7, 1974), pp. 27-33.

In 1965 there were informal discussions between the Company and the FPC Staff concerning a possible rate reduction to the municipal wholesale customers. At a meeting on July 13, 1965 it was agreed by the Staff and Kentucky that Kentucky's wholesale contracts then on file did not preclude a unilateral rate reduction on Kentucky's part, except that Kentucky contended that its contracts with Princeton, Fulton and Paducah were "no changes" agreements which had resulted from lengthy negotiations incident to the cities acquiring the Company's distribution facilities as a prelude to discontinuing commercial relations with the Company. (R. 411). On August 1, 1965, Kentucky filed a $120,000 rate reduction for its wholesale customers as rate schedule WPS-3. (R. 355-410). After a telephone conversation between Company officials and the FPC Staff, the Acting Chief of the FPC's Bureau of Power wrote the Company on August 16, 1965 indicating that some revisions in the filed rate schedules would be appropriate. (R. 411). He further stated that the Staff had reviewed the Princeton, Fulton and Paducah contracts and had concluded that they contained "no restrictions in regard to changes of the WPS rate" and that a rate reduction of $96,000 was warranted for those three cities and Corbin.

The Staff's position was apparently based on the fact that the rate provisions of the Princeton, Fulton, Paducah and Hickman contracts, although embodied in a long agreement covering the sales of the Company's facilities to those cities, was quite similar to the language in the short form contracts with the WPS-5 customers. The Fulton contract, for example, provided as follows:[1]

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[1] R. 69. Fulton argued that this language contained no restrictions on Kentucky's right to effect a rate change by merely filing a new rate with the Kentucky Commission (R. 422-23):

"Article 5 of our agreement states that 'the applicable rate

> "Seller will sell and Purchaser will buy all the power and energy requirements of both the City and the Fringe Systems for the period beginning on the closing date and ending on a date five years thereafter and for successive annual periods thereafter. . . . The applicable rate shall be Seller's published rate designated as WPS, a copy of the applicable provisions of which . . . is attached hereto. . . .

By letter of August 20, 1965, the Company advised the Acting Chief of the FPC's Bureau of Power that it would be willing to file a revised rate (WPS-3R) reflecting an annual reduction of $121,794 to its ten WPS-5 wholesale customers and to include a $24,280 reduction for Corbin. The Company reiterated its position that the contracts with Princeton, Fulton and Paducah were fixed rate contracts. Nevertheless, Kentucky stated that it "would be willing to offer the new rate to these three cities on a five year contract, but we doubt very much that the three who are expecting power from TVA will be interested." Consequently, it proposed to file the new rate only for its ten WPS-5 wholesale customers and Corbin (R. 412-13). After agreement had been reached on the level of rate reduction, Kentucky wrote the Staff on August 27, 1965, indicating that it had been routinely obtaining certificates of concurrence from utility customers where interstate transactions were involved and suggested that perhaps such a procedure might be appropriate for the contemplated rate reduction. (R. 414). The Company also pointed out a further distinction between the Princeton, Fulton, Paducah and Hickman contracts and those with its WPS-5 wholesale customers.

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shall be Seller's published rate designated as WPS'. There is no indication in any part of the agreement setting forth that there would be any restrictions in regard to changes of the WPS rates. It is conceivable that if the Kentucky Utilities Company had requested a higher rate, they would have published the higher rate as their existing WPS rate."

By letter of September 10, 1965, Kentucky formally withdrew its August 1 WPS-3 filing and substituted the WPS-3R rate schedules, stating that it was also making a concurrent filing with the Kentucky Commission. (R. 415-17). With respect to Princeton, Fulton, Paducah and Hickman, the Company reiterated its position that those contracts were "no change" agreements, and that it was not filing a rate reduction for those cities. (R. 147). It is obvious from the foregoing that there was agreement between the Company and the FPC Staff that the contracts between Kentucky and th ten WPS-5 customers were not fixed rate agreements.

Subsequent to its filing, Kentucky informed each customer by letter of the withdrawal and new filing and, in accordance with its earlier suggestion to the FPC Staff, it obtained signatures from the various customers under the following statement:[2]

> Electric rate schedule WPS-3R, attached hereto, is accepted as part of existing contract with Kentucky Utilities Company in place of rate schedule designated therein.

The WPS-3R rate was accepted for filing by a letter of October 22, 1965 from the Secretary of the Commission and made effective as of September 1, 1965. The Secretary's letter made specific reference to Kentucky's contention that it had fixed rate contracts with Princeton, Fulton, Paducah and Hickman and stated that it was requesting comments of those four cities on the point. (R. 425). Since Kentucky had not raised a similiar objection to a rate reduction for the WPS-5 customers, it was clear that neither the Company nor the Staff viewed them as "no change" agreements. Copies of the Secretary's letter were sent to all of the other wholesale customers

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[2] R. 199, 209, 219, 229, 238, 255, 263, 273, 316.

(R. 425-26), so that they were all clearly on notice that Kentucky did not view their contracts as fixed rate contracts, as was already apparent from Kentucky's filing of the WPS-3R rate reduction.

Much of the foregoing activity between the Company and FPC Staff on the WPS-3R rate reduction involved informal conferences and telephone conversations as to which there is no official record other than the correspondence already cited, some of which is not even in the Commission's official files. Nevertheless, the Commission has concluded, without any citation of supporting evidence, that KU's conduct in filing the WPS-3R rate establishes that the underlying contracts were fixed rate agreements (R. 680):

> "A second reason for rejecting KU's contention that the present agreements are "going rate" contracts is the conduct of KU itself. On August 1, 1965, KU made a unilateral filing with the Federal Power Commission and the Kentucky Commission substituting Rate Schedule WPS-5 for WPS-3R. [sic]. The Federal Power Commission informed KU that its filing would not be accepted without customer approval. Ku withdrew the filing and submitted a new one with customers' concurrence which was accepted on October 22, 1965."

The Commission's characterization of what transpired in connection with the WPS-3R filing is a gross distortion of the facts surrounding that filing. The Commission relies only on erroneous conferences to support its conclusion, and the actual circumstances of the filing can only be fully developed at a hearing. What is clear from the limited correspondence in the Commission's official files, which the Commission presumably did not review carefully, is that there was absolutely no dispute that Kentucky had ample authority to file the unilateral rate reduction for its ten

WPS-5 customers. Indeed Staff not only agreed on that interpretation of the WPS-5 contracts, but disputed Kentucky's contention that its other contracts with Princeton, Paducah, Hickman and Fulton were "no change" contracts. It is wholly misleading to assert, as the Commission does, that the reason Kentucky withdrew its August 1, 1965 filing centered on the absence of "customer approval". The available record is abundantly clear, and Kentucky would establish at a hearing, that the August 1 filing was withdrawn solely because the Staff had raised further questions about the level of reduction proposed and the propriety of similarly reducing rates for Princeton, Paducah, Fulton and Hickman.

While Kentucky did have its customers indicate their acceptance of the WPS-3R rate, there is nothing in the record to suggest that it did so because either it or the Staff thought that the WPS-5 rate was "fixed". The reason for that action is not clear from the available correspondence in the record, but Kentucky contends that it did so as a routine procedural matter in accord with its continuing cooperation with the Commission Staff dating back to 1962. If Kentucky had believed that it had bargained for and obtained a fixed rate when executing the WPS-5 contracts in 1963, it obviously would have asserted its contractual rights a year and a half later and resisted a rate decrease amounting to $122,000 annually to those customers and $24,280 to Corbin. It did not do so. However, in an action which fully confirms its interpretation of the WPS-5 contracts, it did resist rate reductions to Princeton, Paducah, Hickman and Fulton on the grounds that it had negotiated fixed rate agreements with those cities as a part of the consideration of the purchase price for the Company's facilities condemned by those cities. Ironically, the Staff opposed Kentucky's interpretation of those contracts and supported the claims of those cities in later proceedings that they were entitled to the same

rate reduction afforded the WPS-5 customers, a dispute which was finally resolved by Kentucky agreeing to refund those cities the portion of the difference between billings at the rate charged those cities and the lower WPS-3R rate charged the ten WPS-5 customers.[3] Having been persuaded by the Staff to grant the WPS-3R reduction to the WPS-5 customers in 1965, and having subsequently been forced to afford Hickman, Paducah, Princeton and Fulton equal treatment on the ground that their contracts, like the WPS-5 contracts, were not fixed rate agreements, Kentucky has now been denied the right to file a proposed rate increase for its municipal wholesale customers on the ground that those same contracts now must be construed as precluding unilateral filings. The Commission and the customers simply cannot have it both ways. Kentucky contends that the original interpretation of the WPS-5 contracts by the Company and the Staff was correct, and that if the matter may not technically be *res adjudicata,* the Commission should in any event be estopped from abandoning that earlier interpretation.

"Reply Brief for Petitioner" (February 25, 1974), pp. 10-12

III. THE DISPUTED FACTUAL CIRCUMSTANCES SURROUNDING THE EXECUTION OF THE CONTRACTS, THEIR INTERPRETATION BY KU AND THE FPC STAFF, AND THEIR PRACTICAL CONSTRUCTION BY KU AND THE CITIES REQUIRE A HEARING.

The Commission brief does not attempt to answer Kentucky's version of the events surrounding its 1963 and 1965 rate reduction to the Cities, which KU asserts clearly shows that the FPC Staff at that time clearly recognized that the service agreements were not fixed rate contracts. (Br. 26-30). Instead it falls back on the erroneous characterization of the 1965 events by the Commission in its order below. Similarly, it ignores KU's explanation of the 1969 fuel clause filing and reiterates the Commission's conclusion below that "both these filings by KU and its subsequent action in accordance with the Commission's directives shows a clear intent on the part of KU to treat the agreements as fixed rate contracts." (Br. 25-26). The Cities take a similar position (Br. 19-20). Neither of them even addresses, let alone answers, KU's detailed exposition and explanation of the disputed circumstances.

[3] *Electric Plant Boards of the Cities of Paducah, Princeton, Fulton and Hickman, Kentucky* v. *Kentucky Utilities Company,* 40 F.P.C. 978 (1968).

The contention that KU, its customers and the Commission Staff have consistently treated the service agreements as fixed rate contracts is patently and demonstrably false. The only contracts that KU ever contended were fixed rate agreements were those with Princeton, Fulton and Paducah, a contention which the Staff disputed and as a result of which KU eventually agreed to grant those Cities the same reductions which the present intervenor Cities received in 1965. (KU Br. 32-33). As a result of that experience, when KU subsequently negotiated an actual fixed rate contract of December 1, 1967, with the Jackson Purchase Rural Electric Cooperative, it took pains to make its intention abundantly clear. That contract, executed at a time after all of the currently effective contracts had already been interpreted as "going rate" contracts by KU and the Commission Staff and that interpretation communicated to all of the Cities,[4] provides as follows (para. 13);

[4] KU Br. 27-30. We digress to note the Cities' gratuitous innuendo at page 22 of its brief where it refers to "unreported *ex parte* meetings and telephone conversations between KU and Commission staff members," and rather awkwardly questions the propriety of those meetings and conversations. The technique of painting a black hat on your opponent rather than addressing his arguments is a standard practice of some lawyers. Here, however, the effort seems misguided. There were no formal proceedings under way, but only informal negotiations between Staff and KU, which is a common

> It is the intent of the parties that the rate and other provisions affecting Cooperative's costs remain constant throughout the term of this contract. It is agreed that neither party will seek a change in the rate or in any other provision which would increase or decrease Cooperative's costs.

It is incomprehensible that KU would tailor such language for Jackson Purchase if in fact it viewed its boilerplate, short form contract language as already precluding rate changes as the Commission and Cities now contend.

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practice at the Commission. Hence the events referred to hardly can be characterized as "ex parte" in any customary sense of the phrase. In any event, the results of those negotiations were fully communicated to the Cities, including the views of KU and Staff that the contracts were not fixed rate agreements. KU Br. 30. There were no objections to that conclusion from the Cities.

APPENDIX B

UNITED STATES OF AMERICA
FEDERAL POWER COMMISSION

Opinion No. 764

Metropolitan Edison Company

Docket No. E-8832

Opinion and Order Affirming and Adopting Initial Decision

Issued: June 1, 1976

APPEARANCES

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Phillip D. Ardery for Borough of Middletown, Pennsylvania

Daniel P. Behuniak for Staff, Federal Power Commission

DUNHAM, Chairman:

This case arises out of Metropolitan Edison Company's (Met-Ed) petition filed March 6, 1974, requesting the Commission to investigate that company's wholesale rate to the Borough of Middletown, Pennsylvania. That rate is fixed by contract dated July 14, 1906, at 1¢ per kwh for as much power as Middletown requires. The petition further requested that the contract rate be replaced by Met-Ed's tariff rate RT, applicable to the company's other 69 Kv wholesale customers. Pursuant to the Commission's order issued June 6, 1974, a hearing on the petition was held December 11 and 12, 1974, before Administrative Law Judge Jensen. The Judge's initial decision was issued

September 2, 1975, and exceptions were filed by Staff and Metropolitan Edison. The Borough of Middletown, the sole intervenor in the case, subsequently filed a Brief Opposing Exceptions as did Staff.

The 1906 contract was made between York Haven Water & Power Company (Met-Ed's predecessor) and the Borough and was accepted on July 14, 1906. The parties agreed that the utility would supply the borough with electricity at 1¢ per Kwh. The contract also provided that it would continue: "in full force indefinitely until terminated by the Borough upon 6 month's notice in writing to the Company." Met-Ed alleges that this contract is unjust and unreasonable since it no longer covers even operating expenses and thereby impairs the company's ability to raise capital and carry out its service obligations. Further the contract is alleged to be discriminatory and to constitute an undue burden on Met-Ed's other customers.

The Presiding Administrative Law Judge found that there was no impairment of Met-Ed's financial ability to continue service, that there was no undue discrimination caused by the contract and that there is no excessive burden upon other customers of Met-Ed. Further, the Judge found that other aspects of the public interest support maintenance of the agreement. He thus upheld the fixed-rate contract and did not reach the question of the rate to be imposed in lieu of the contract rate.

The Supreme Court in *Federal Power Commission* v. *Sierra Pacific Power Co.*,[1] clearly stated that a fixed-rate contract must be more than mildly unprofitable in order for the Commission to overturn it. The *Mobile-Sierra* test requires that the total impact of the contract be assessed from a public interest perspective, three elements of which are set out in the opinion. The key factor are whether

[1] 350 U.S. 348 (1955), See also, *United Gas Co.* v. *Mobile Gas Corp.* 350 U.S. 332 (1955).

the contract "might impair the financial ability of the public utility to *continue* its service, cast upon other customers an *excessive* burden, or be *unduly* discriminatory" (350 U.S. at 355; emphasis added).

According to the evidence in this proceeding, Met-Ed's total electric revenue for the 12 months ending July 31, 1973, was $172.5 million. Its net electric operating income was $36.6 million. Based on the rate Met-Ed would have the Commission adopt in their proceeding, Middletown's 1¢ rate produced a $500,000 shortfall for the last 11 months of 1974.

The *de minimis* nature of this deficit compared to Met-Ed's total electric revenues is the critical element in considering the effect on the public interest of the instant rate. While the utility argues that it has been forced to make substantial cuts in its *operations* budget, these cuts cannot be rationally associated with the Middletown contract. It is clear, certainly, that the $500,000.00 deficit incurred on the Middletown contract adversely affects the financial health of the company, but there is nothing in the record or the briefs to indicate that this deficit will, in any material way, impair the company's ability to continue service either to Middletown or to the remainder of Met-Ed's customers.

Met-Ed cites *Carolina Power & Light Co.*, Docket No. E-9991, Opinion No. 717, issued December 17, 1974, as grounds for finding financial impairment to the point of affecting its ability to continue service. In *Carolina* we indicated the criteria by which the impairment of financial abilities to continue service would be measured: "[O]ne is the amount by which the utility's revenues from the rate in question exceed its costs . . . and the other is the remaining effective period of the rate in question."[2] Met-

[2] *Carolina Power and Light Company*, Opinion No. 717, issued December 17, 1974, mimeo at 3. See also, Met-Ed's Brief on Exceptions at 10.

Ed's argument on this point, however, ignores *Appalachian Power Co.*, Docket No. E-7775, issued June 9, 1975. There we noted that a revenue deficiency (of $600,000.00 on six fixed-rate contracts) must be compared to the utility's total sales in order to ascertain its impact on the utility's continuation of service. There, as here, "it is clear that an inability to continue service could not possibly result from the continued operation of the contracts in question."[3] The Middletown contract does not adversely affect the public interest by impairing Met-Ed's ability to continue service and we will uphold the Presiding Law Judge's decision on this point.

Moving to the second element of the *Sierra* test, the question is whether Middletown's contract casts upon other consumers an excessive burden. The utility did not adduce substantial evidence indicating that the Middletown contract burdened Met-Ed's other customers excessively. In fact, Met-Ed's own witness, the Vice President of General Public Utilities Service Corporation (Met-Ed's parent) conceded that the revenue deficiency of Middletown was not passed on to the other customers of Met-Ed in any way.[4] Even if the deficiencies occasioned by the Middletown contract were borne by the other customers of Met-Ed, that fact standing alone would not be dispositive. The *Sierra* test requires an *excessive* burden on other customers. It is doubtful indeed that the revenue shortfall of the size involved here could ever cast such a burden upon the other customers of a utility the size of Met-Ed.[5] This is not to say, however, that at a future date the losses sustained as a result of Met-Ed's self-imposed, albeit improvident, bargain might not begin to cast some

[3] Appalachian Power Co., mimeo at 4-5.

[4] Tr. at 270-71.

[5] As noted *supra*, pp. 2-3, Met-Ed had revenues of $172 million and income of $36 million in fiscal year 1973.

burdens on other customers, conceivably even to the point of coming within the *Sierra* guidelines. That point, however, simply has not been reached at this juncture.

The only remaining question is whether the contract rate is unduly discriminatory. The Presiding Judge found in the negative. In addition, he found that the Borough of Middletown, if anyone, had been discriminated against by the rate for the last 65 years. Comparing Middletown to Kutztown (a similar community on Met-Ed's rate "RT") as Met-Ed and Staff desire, it is clear that the rate charged Middletown is and has been lower.[6] The larger question is whether this difference is "undue discrimination" in the language of *Sierra*.

A comparison of the Middletown rate with the average rate charged Hershey Electric Co. since 1969 reveals that the average rate to Hershey is .92¢. When compared to the average revenues from all resale customers over the same period, Middletown's rate is one half mill higher per Kwh. The issue thus framed is against what yardstick is discrimination to be measured? Even assuming *arguendo* that Kutztown is the appropriate measure, the problem to be resolved is whether discrimination is undue. Is there a factual basis by which the discrimination can be justified? There appears to be no difference between the two towns based upon cost of service, in fact, the only differences appear to be Middletown's 1906 contract and the consideration given by the community at that time.[7]

[6] The average rate charged Kutztown in selected years (1937, 1945, 1955, 1965, 1969, 1970, 1971, 1972, and 1973) has been 1.29¢, according to Met-Ed's FPC Form 1 (Tr. 443).

[7] The 1906 contract recites:

> "Inasmuch as the Borough is practically abandoning its present electric light plant at great loss to itself and has been induced by the company as a matter of economy and advantage to the Borough, it is agreed that this contract shall continue in full force indefinitely until terminated by the Borough. . . ."

Even finding discrimination, the question must be asked, "Who is damaged?" There is no contention that Kutztown's is not a just and reasonable rate; nor even that all other parties to rate RT are not paying just, reasonable and non-excessive rates.[8] Even if there is discrimination, there appears to be no damage to these third parties. They would receive no reductions were we to uphold Met-Ed's position here. Even were damages to be found, the fact that Middletown's customers would sustain a 50% rate increase raises substantial questions regarding whether the public interest would best be served by bailing Met-Ed out of its unwise bargain. The equities, once balanced, favor upholding the contract.

However distasteful the Middletown contract is to Met-Ed, this Commission cannot undo what the company has done unto itself. While we may sympathize with Met-Ed, we can do no more. The law is clear and we must affirm and adopt the Initial Decision herein.

The Commission finds:

Consistent with the discussion in this Opinion, the Initial Decision in this proceeding should be affirmed and adopted and the exceptions thereto denied.

The Commission orders:

Consistent with the discussion in this Opinion, the Initial Decision in this proceeding is affirmed and adopted and the exceptions thereto are denied.

By the Commission.
(SEAL)

KENNETH F. PLUMB
Secretary.

[8] Neither Kutztown, Hershey nor any other Met-Ed customer has complained of discrimination on account of the Met-Ed contract, nor have any customers intervened in this proceeding.

APPENDIX C

UNITED STATES OF AMERICA
FEDERAL POWER COMMISSION

Before Commissioners: Richard L. Dunham, Chairman; Don S. Smith, John H. Holloman III, and James G. Watt.

Metropolitan Edison Company

Docket No. E-8832

Order Denying Rehearing

(Issued July 30, 1976)

On March 6, 1974, Metropolitan Edison Company (Met-Ed) filed a petition requesting the Commission to investigate that company's wholesale rate to the Borough of Middletown, Pennsylvania. That rate was fixed by contract dated July 14, 1906 at 1¢ per kwh for as much power as Middletown required. The hearing on the petition was held December 11 and 12, 1974 before an Administrative Law Judge and an initial decision was issued September 2, 1975. Exceptions were filed and on June 1, 1976 we issued Opinion No. 764, Opinion and Order Affirming and Adopting Initial Decision. In that opinion we noted that the appropriate legal test had been set forth by the Supreme Court in *Federal Power Commission* v. *Sierra Pacific Power Company.*[1] In that case the Court stated that the Commission could only reform a fixed rate contract when to do so would be in the public interest. The Court also set out three elements of the public interest which we must consider. These factors are whether the contract, "might impair the financial ability of the public utility to continue its service, cast upon

[1] 350 U.S. 348 (1955).

other customers an excessive burden or be unduly discriminatory." In Opinion No. 764, we concluded that the Middletown contract with Metropolitan Edison could not be reformed by us on the basis of *Sierra Pacific Power Company*.

On July 1, 1976, Metropolitan Edison filed an application for rehearing of Opinion No. 764. The company contends that "the Commission reaches [its] conclusion only by a clear error of law: its theory that undue discrimination cannot exist if other wholesale customers receiving the same wholesale service as Middletown would receive no rate decrease if the Borough's rate is set aside."[2] The company argues, "the words 'undue discrimination' had a well established and clearly understood meaning at the time of the *Sierra* decision, namely, the difference of rates among customers of the same class which is not justified by differences in cost of service, operating conditions, or other considerations."[3]

We accepted the company's definition of undue discrimination in Opinion No. 764. At page 5 of that opinion we stated, "the problem to be resolved is whether discrimination is undue. Is there a factual basis by which the discrimination can be justified?" We concluded "there appears to be no difference between the two towns based upon cost of service, in fact, *the only differences appear to be Middletown's 1906 contract and the consideration given by the community at that time.*"

Kutztown (the customer most comparable with Middletown according to Met-Ed) does not have the benefit of a similar contract. Nor does it appear that any other customer of Met-Ed is so lucky. The fact of the contract cannot, however, be ignored. This contract, undesirable as it may be to Metropolitan Edison is certainly an

[2] Application at 2.

[3] Application at 6 (citations omitted).

operative "other consideration" as set forth in the company's own definition of undue discrimination.

That the 1906 contract is sufficient for us to make a finding of no illegal discrimination is implicit above. That finding is, however, made indefinitely easier where, as here, "there is no contention that Kutztown's is not a just and reasonable rate; nor even that all other parties to Rate RT are not paying just, reasonable and non-excessive rates . . . there appears to be no damage to these third parties."[4]

Met-Ed next contends that "because of the extremely favorable, less than cost-based rate available to Middletown in perpetuity, there is no way for Met-Ed, for Met-Ed's other customers and, indeed, for any supplier of electricity in the country to successfully [sic] compete with Middletown in terms of the power supply advantage it can offer to any industrial or other entity contemplating a move."[5] In support of this argument, Met-Ed cites *Federal Power Commission* v. *Conway Corp.*, 44 U.S.L.W. 4777 (June 8, 1976). They suggest that the situation here might be described as a reverse price squeeze which is just as inimical to the public interest.

This argument ignores the essential differences between a rate fixed by contract and a rate established by this Commission. In the former circumstance we are precluded by *Sierra Pacific* (*supra*) from imposing a rate other than that agreed to by the parties except in those situations set forth in *Sierra*. In the latter circumstance the Commission is charged with the act of rate making or at least with *de novo* review of the rate. This was the situation in which *Conway* arose.

The facts of this case simply do not allow a finding of a price squeeze. The 1906 contract established the

[4] Opinion No. 764 at 6.

[5] Application at 9.

relationship of the parties. That the price might ultimately become unfair to either party surely was considered by the drafters of the document. To the extent that Middletown might come to have a competitive advantage over Met-Ed, it is an advantage which could have been forseen and remedied by the York Haven Water and Power Company (Met-Ed's predecessor in interest) in 1906. To the extent that a price squeeze does exist, it is a self-imposed squeeze and one with which the parties must live. It is certainly distinguishable from the circumstances giving rise to *Conway*. Absent certain conditions as set forth above, this Commission is powerless to modify or extinguish the rights and duties the parties set for themselves in that contract. Metropolitan Edison has not set forth additional facts or theories of law which were not considered by us in reaching our determination that the Middletown contract, while discriminatory, is not unduly so.

In Opinion No. 764 we stated

> "Even were damages [occasioned by undue discrimination] to be found, the fact that Middletown's customers would sustain a 50% rate increase raises substantial questions regarding whether the public interest would be served by bailing Met-Ed out of its unwise bargain. The equities, once balanced, favor upholding the contract."[6]

Met-Ed argues that there is no evidence to support our conclusion that such a balancing does in fact favor upholding the contract. The company notes that over the years 1937 through 1975 Middletown has paid $2.5 million less than it would have, had it been charged the same rate as Kutztown, allegedly the appropriate measure of comparison. This fact represents one side of what can be termed the equitable equation. The other side of that

[6] Mimeo at 6.

equation, as we expressed in Opinion No. 764 is the fact that Middletown's customers would sustain a 50% rate increase were Middletown to be deprived of its contract right. The "balancing" in which we engaged in Opinion No. 764 involved an interpretation of these two facts. The unspoken question addressed by us was whether a $2.5 million shortfall over a period of some twenty-eight years by a company having a total electric revenue of $172.5 million for the year ending July, 1973 was more grievous than the potential 50% increase in rates to Middletown customers. The function of this Commission "is not only to appraise the facts and to draw inferences from them but also to bring to bear upon the problem an expert judgment and determine from [our] analysis of the *total situation* on which side of controversy the public interest lies."[7] Our analysis is certainly within our discretion and, as noted above, fully supported by the evidence.

Met-Ed next argues that our comparison of the revenue deficiency occasioned by the Middletown contract with the company's total electric revenue and total electric operating income was an erroneous application of the Supreme Court's *Sierra* test. That comparison is premised upon our reading of *Appalachian Power Company* Docket No. E-7775 issued June 9, 1975. There we stated, "It is clear that an inability to continue service could not possibly result from the continued operation of the [six fixed rate] contracts in question."[8] Here Met-Ed suggests that the Supreme Court merely required an impairment of financial condition as opposed to an inability to continue service. It ignores, however, the critical portion of the Supreme Court test. The significant language in the *Sierra* test is not whether or not the contract merely

[7] *United States* v. *Detroit and Cleveland Navigation Company*, 326 U.S. 236 quoted in *Federal Power Commission* v. *Transcontinental Gas Corporation*, 365 U.S. 1, 7 (1960) (emphasis added).

[8] Appalachian Power Company, mimeo at 4-5.

impairs the financial condition of the utility but rather whether it impairs the ability of the utility to *continue* service. When the continuation of service is seen to be the issue, the relevance of our comparison in *Appalachian Power Company* is apparent. The fact that service is unprofitable, or as here, producing a loss, is an inadequate basis for modifying the contract. The contract must be *so* unprofitable as to impact significantly upon the ability of the company to maintain and continue its operations. Here there is no allegation that absent our intercession the Middletown contract will bring to a halt Metropolitan Edison's operations.

We do not dispute that the company has and will probably continue to suffer negative effects from the Middletown contract. These effects, however, simply do not rise to the level contemplated by the Supreme Court in the *Sierra* test. Inasmuch as Met-Ed has not suggested any legal theory or new facts which we did not consider in our deliberations on Opinion No. 764, we are compelled to deny the company's application for rehearing on the question of the impairment of Met-Ed's ability to continue service.

The final argument advanced by Met-Ed is that the public interest is adversely affected in other ways not mentioned in the *Sierra* examples and not discussed by us in Opinion No. 764. This argument is merely a reiteration of its brief on exceptions. We considered the impact of this contract on Met-Ed's construction program and its work force. The company has shown no reason for us to reconsider those arguments at this point. Accordingly we will deny rehearing on the other public interest impact of the Middletown contract.

The Commission finds:

That no grounds exist for granting rehearing of our Opinion No. 764 Order Affirming and Adopting Initial Decision issued June 1, 1976.

The Commission orders:

Rehearing of our Opinion No. 764, Opinion and Order Affirming and Adopting Initial Decision, issued June 1, 1976 is hereby denied.

By the Commission.

(S E A L)

Kenneth F. Plumb,
Secretary